

# The Role of the Office for Budget Responsibility

---

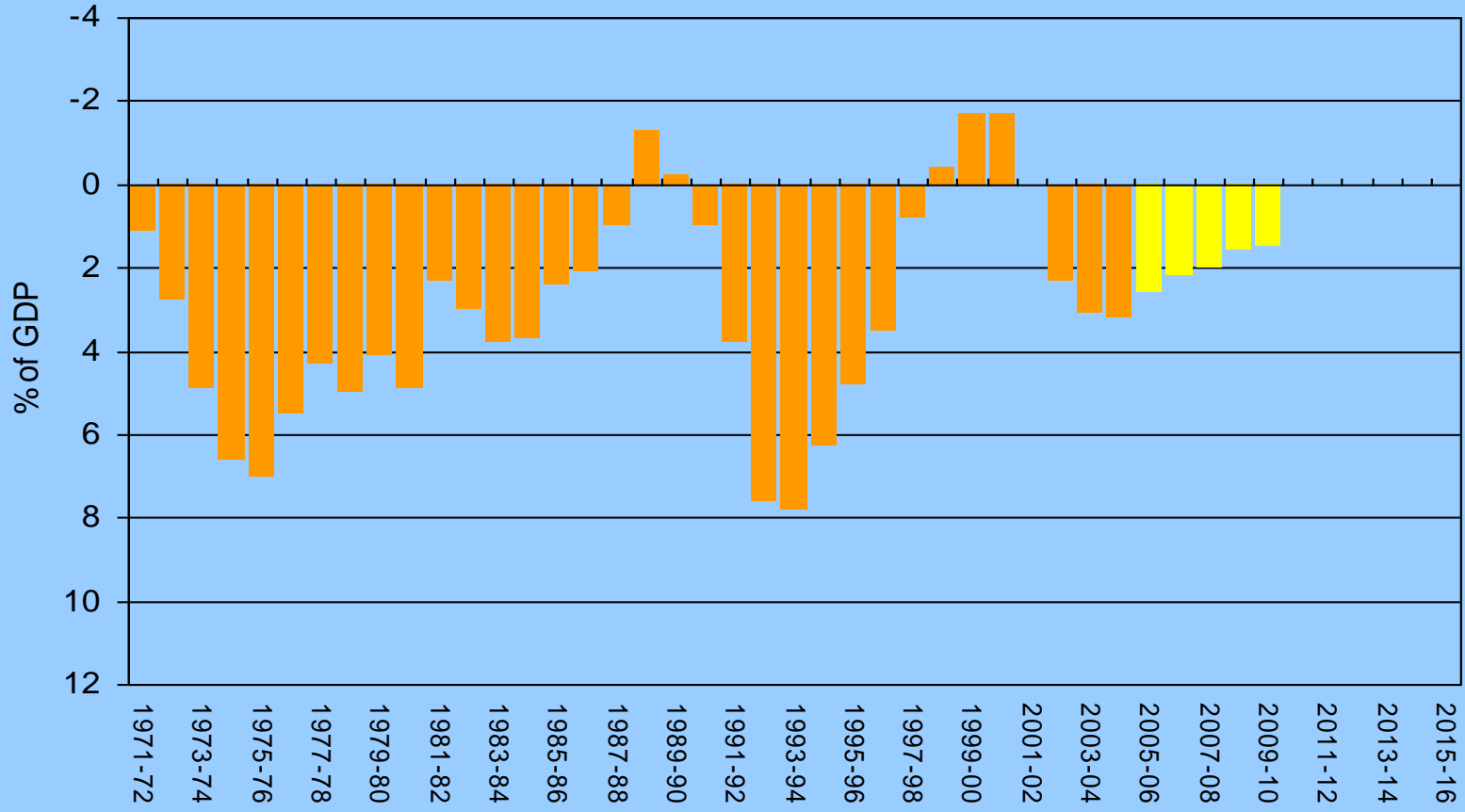
April 2013

Jon Riley, OBR

# The UK's Fiscal Position (1)

Public sector net borrowing

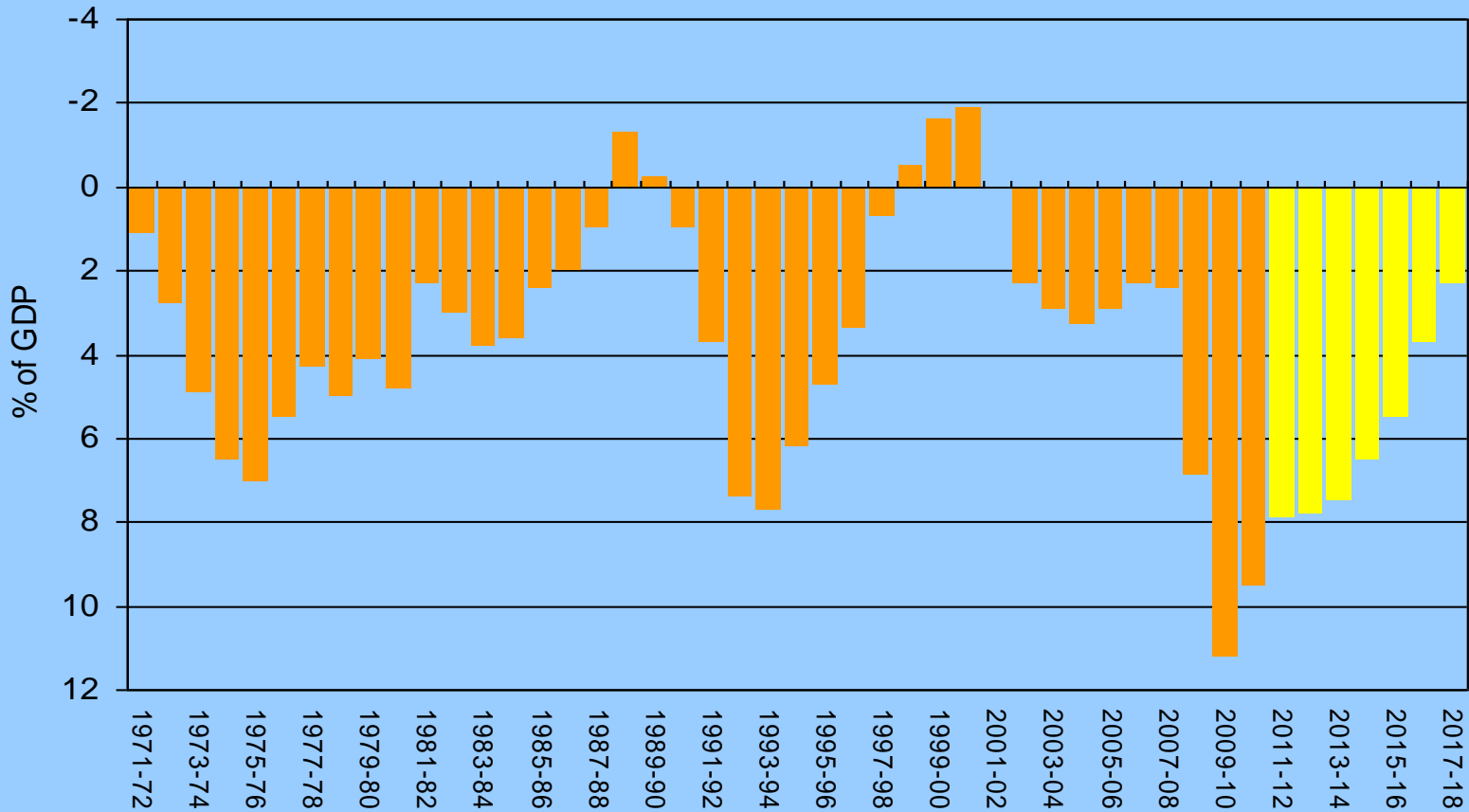
HM Treasury *Budget 2005*: outturns and forecasts



# The UK's Fiscal Position (2)

Public sector net borrowing

OBR *Economic and fiscal outlook* March 2013: outturns and forecasts



# The Government's Fiscal Strategy

New government elected in May 2010. Their fiscal strategy consisted of three elements.

- setting fiscal policy to restore public finances to a sustainable position
- a fiscal mandate to guide fiscal policy decisions over the medium-term
- creating the new Office for Budget Responsibility (OBR)

# Fiscal Mandate (1)

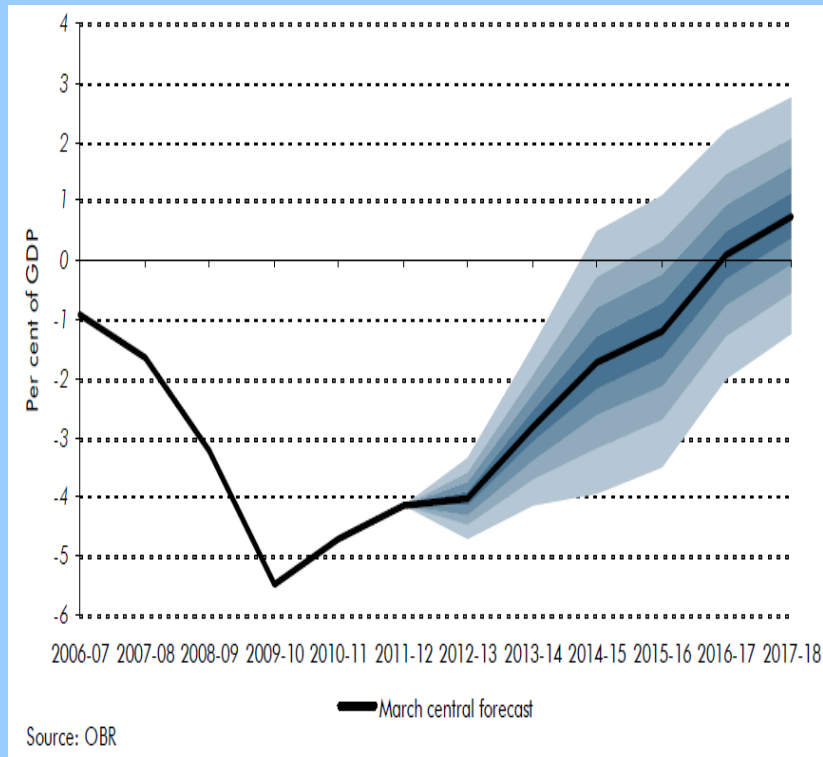
- Chancellor has set a fiscal mandate
  - Cyclically adjusted current balance by the end of the rolling five year forecast period (i.e. 2017-18)
- Supplementary target
  - Public sector net debt falling between 2014-15 and 2015-16

## Why this mandate?

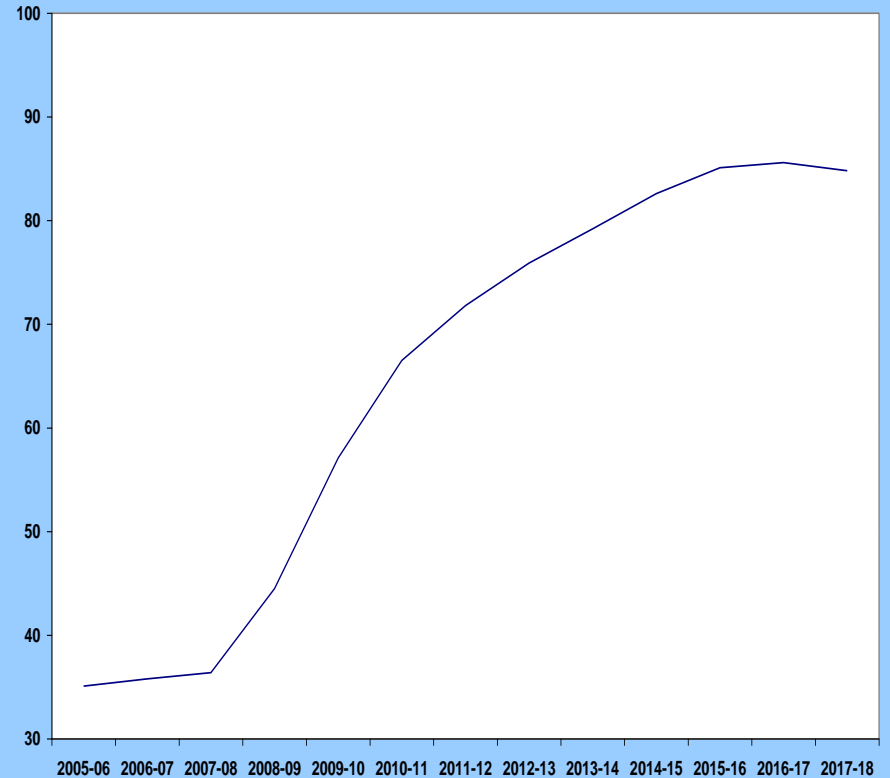
- Current Balance (i.e. measure excludes public investment)
- Cyclically adjusted aggregate, to allow some fiscal flexibility at a time of economic uncertainty

# Fiscal Mandate (2)

## Cyclically-adjusted current budget fan chart



## Public Sector Net Debt (% of GDP)



## Key roles of the OBR

- Created in May 2010 to provide independent and authoritative analysis of the public finances. One of a growing number of official independent fiscal watchdogs
- Produces the official Budget and Autumn forecasts of the economy and public finances
  - Assessment to the extent to which the fiscal mandate has been met
- Certify Policy Costings
- Report on the sustainability of the public finances (long-term fiscal projections)
- Raise transparency of the public finances
- OBR must only consider the impact of current government policy, not alternative policies

# Rationale for the OBR

- **General rationale:** combating ‘deficit bias’ and ‘pro-cyclicality’
- Push by international organisations for the setting up of independent fiscal councils

OECD (2010) “*Experience and empirical evidence suggest that delegating macroeconomic forecasting to an independent fiscal council can reduce forecasting bias*”

EU (2010): “*Independent bodies entrusted with some technical tasks of the budgetary process have also proved effective in promoting sound policies*”

- **UK rationale:** fiscal forecasts without political wishful thinking
- Government concern that there was a tendency for optimism bias in the forecasts, which were signed off by Ministers



# How does the OBR operate?

- Legislation establishes OBR's complete discretion over forecast judgements, a clear set of responsibilities and a right to access information
- Budget Responsibility Committee – responsible for the judgments underpinning the forecast
- OBR Secretariat (17 strong) – includes economic forecasters, fiscal forecasters (whose main role is to scrutinise HMRC/DWP forecasts), press office, strategy and long-term analysts
- OBR needs to work closely with government officials. This is a key challenge as OBR operates both inside of Government and independently
- Accountable to Chancellor and to Treasury Select Committee

# The Office for Budget Responsibility

## Budget Responsibility Committee



**Graham Parker**



**Robert Chote**



**Prof S Nickell**

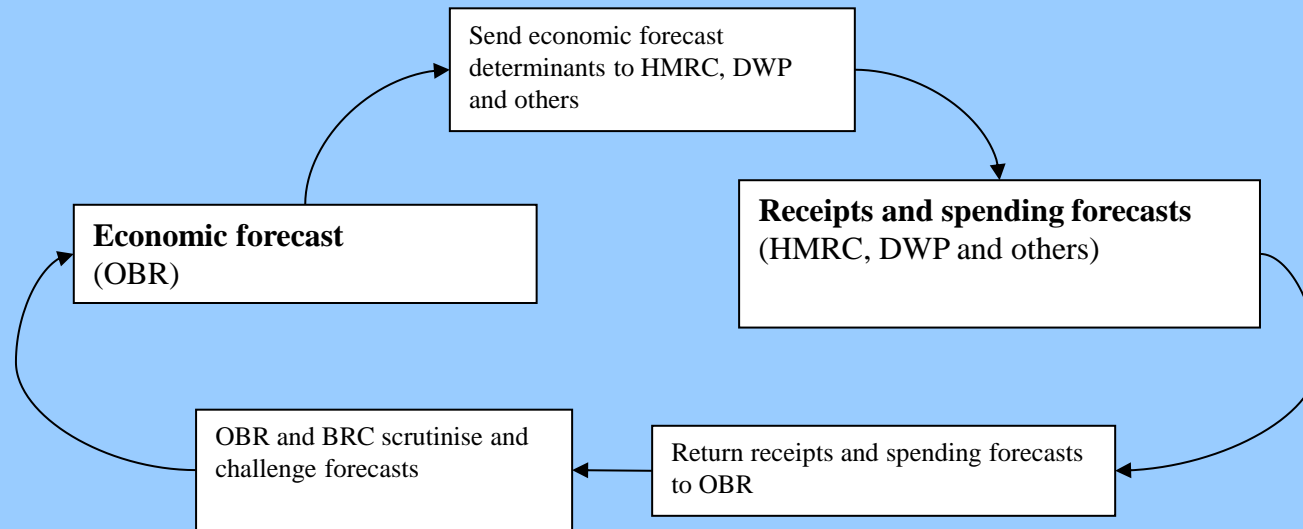
**Head of staff**

**Fiscal forecast & costings**  
(9 staff)

**Economy forecast**  
(6 staff)

**Communications & management**  
(2 staff)

# How does the OBR do a fiscal forecast?



- Disaggregated bottom-up forecast built up from many separate forecasts of revenue and spending
- Forecasting models: HMRC and DWP have a variety of econometric/microsimulation models
- Scrutiny and Challenge: BRC and OBR officials meet those responsible for running receipts/expenditure models. Often results in changes of assumptions and judgments
- Also incorporate policy measures into final fiscal numbers

# Transparency

- Greater detail on receipts and expenditure forecasts
- Publish full set of economic determinants for fiscal forecast
- Diagnostics on why forecasts have changed
- Sensitivity analysis (e.g. to changes in gilt rates, to changes in the size of the output gap)
- Scenario analysis (alternative economic scenarios)
- Publish full assessment of past forecast errors
- Publish full details of contacts with Ministers

# Certifying Policy Costings

- OBR scrutinises and certifies policy costings included in the Budget and Autumn Statement are reasonable and central
  - Tax measures
  - Annually Managed Expenditure (AME) measures e.g. benefits
  - Do not look at departmental expenditure allocations
- These policy measures are then included in the final fiscal forecast
- All costings are produced on the basis of the OBR's economic forecast
- OBR would look at pre-behavioural (static) and post-behavioural yield of measures (e.g. by using elasticities to estimate changes in demand)
- OBR would include any economy-wide effect of measures into the economic forecast (e.g. the impact of a VAT rise on GDP growth and inflation)

# Fiscal Sustainability (1)

- Looking at fiscal sustainability up to 40-50 years out

Issues to be covered would include:

- the impact of demographics on spending
- the sustainability of the tax base
- the impact of recent policy decisions e.g. higher education, public service pensions, social care etc
- evolution of the public sector balance sheet

# Fiscal Sustainability (2)

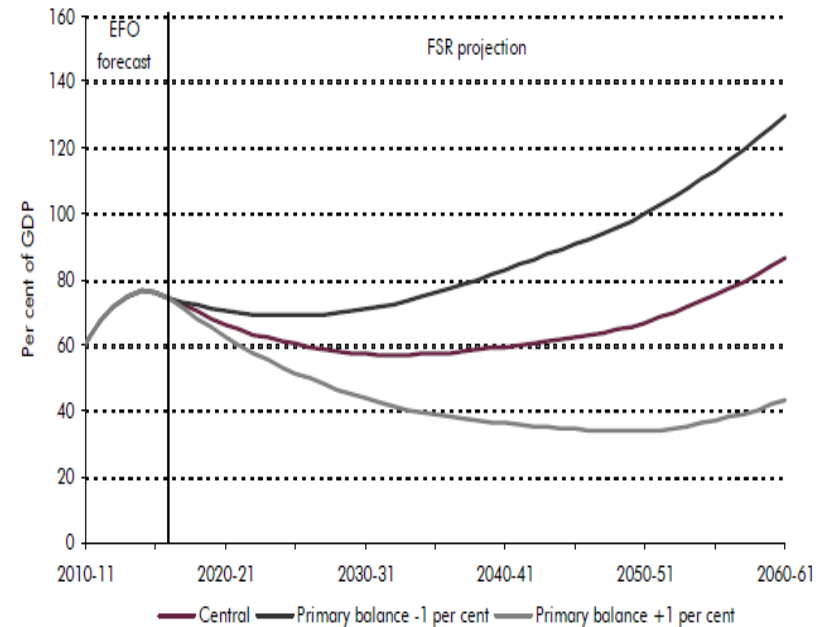
## Non-interest spending projections

	Per cent of GDP							
	Estimate <sup>1</sup>		FSR Projection					
	2011-12	2016-17	2021-22	2031-32	2041-42	2051-52	2060-61	2061-62
Health	8.1	6.8	7.1	7.7	8.3	8.7	9.0	9.1
Long-term care	1.3	1.1	1.2	1.5	1.7	1.9	2.0	2.0
Education	5.7	4.5	4.6	4.6	4.4	4.4	4.5	4.5
State pensions	5.7	5.6	5.3	6.1	7.0	7.3	8.2	8.3
Pensioner benefits	1.2	1.1	1.1	1.2	1.3	1.2	1.2	1.2
Public service pensions	2.1	2.2	2.0	1.7	1.5	1.3	1.3	1.3
<b>Total age-related spending</b>	<b>24.1</b>	<b>21.3</b>	<b>21.3</b>	<b>22.8</b>	<b>24.2</b>	<b>24.9</b>	<b>26.2</b>	<b>26.3</b>
Other social benefits	6.3	5.1	5.3	5.2	5.1	5.2	5.2	5.2
Other spending	12.2	9.2	9.2	9.2	9.2	9.3	9.3	9.3
<b>Primary spending<sup>2</sup></b>	<b>42.6</b>	<b>35.6</b>	<b>35.8</b>	<b>37.2</b>	<b>38.5</b>	<b>39.4</b>	<b>40.7</b>	<b>40.8</b>

<sup>1</sup> Total spending consistent with the March 2012 *EFO*.

<sup>2</sup> Excludes interest and dividends.

Chart 3.12: Sensitivity of public sector net debt projections to the primary balance in 2016-17



Source: OBR

# International Comparisons of Fiscal Councils (1)

- Independent central banks much more similar to each other than fiscal councils. Diverse group of fiscal councils e.g. Congressional Budget Office (U.S.), Central Planning Bureau (Netherlands), Fiscal Policy Council (Sweden)

Fiscal councils differ:

- Own forecasting / evaluating government forecasts
- Monitoring fiscal rules
- Extent to which medium-term fiscal objectives attained/ analyse appropriateness of objectives
- Positive analysis/ normative policy recommendations
- Remit confined to fiscal policy only?
- Analysis of long-term sustainability
- Size of organisation: OBR(20), Sweden (12), CBO (250), CPB (170)



## International Comparisons of Fiscal Councils (2)

	UK (OBR)	US (CBO)	Sweden (FPC)
Own Forecasting	X	X	
Evaluate Govt forecasts			X
Evaluate fiscal rules are met	X	X	X
Analysis of long-term sustainability	X	X	X
Normative recommendations			X
Analysis of wider issues		X	X

# Annex

# The Government's Spending Review + Budgeting Framework

Spending can be split into:

- **Departmental Expenditure Limits (DEL):** Fixed limits for spending by departments (e.g. health, defence).
- **Annually Managed Expenditure (AME):** Not set within fixed limits. Often demand-led and economy-driven e.g. pensions, benefits, debt interest
- Spending Review announced in October 2010. Sets fixed DEL plans out to 2014-15. Spending Review to set plans for 2015-16 in June
- Spending assumption for years beyond 14-15. Assumes similar spending constraint to Spending Review period